Legacy Trust

Investment Perspectives

Positioning for Recovery

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Key Takeaways

- Covid-19 has slowed global economic output and demand for an indefinite amount of time.
- With so many uncertainties related to the pandemic (such as infection rate and effectiveness of efforts to contain), it is impossible to know if risk assets are oversold or what shape a recovery might take.
- Despite many unknowns, investors can be fairly confident that consumer preferences are likely to be unchanged when normalcy returns, ushering in an eventual recovery.

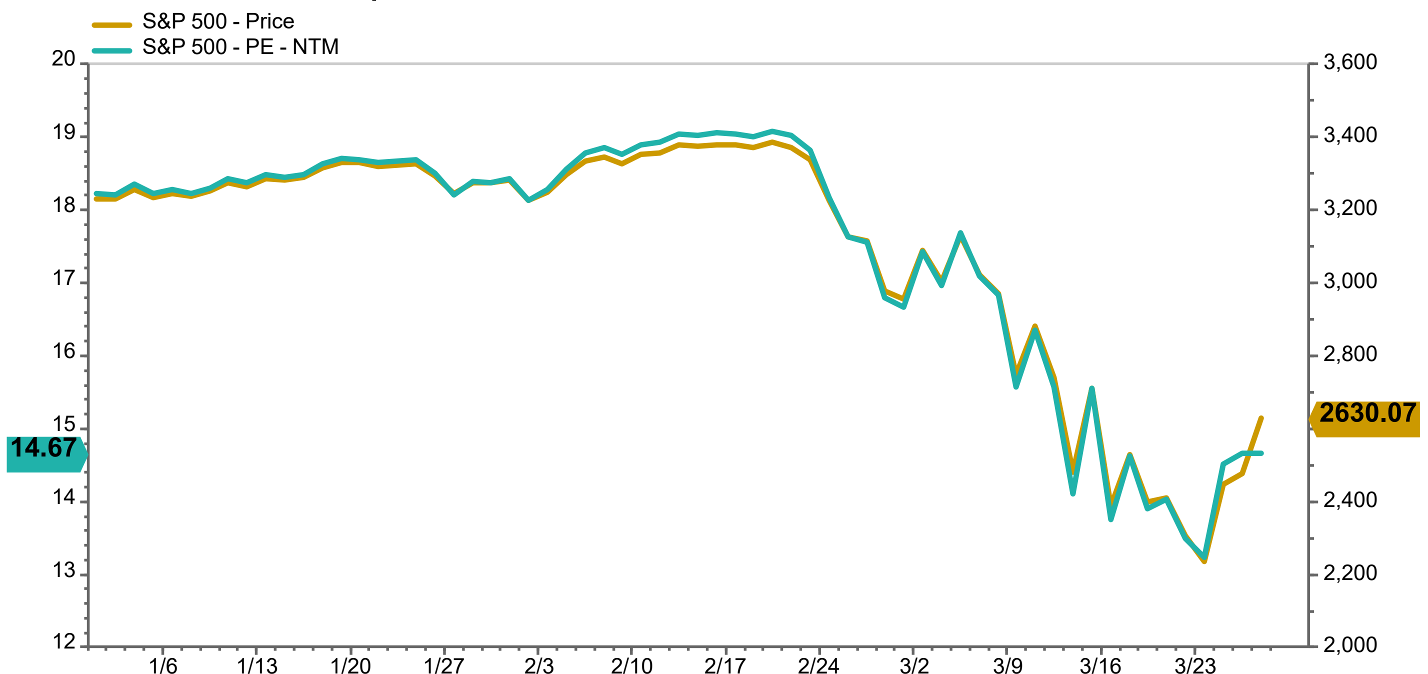
Investors continue to weigh the impacts of Covid-19 as efforts for containment flow through to every segment of the global economy. Acknowledging that there is no direct precedent for navigating the current environment, investors with a long-term horizon can opportunistically realign portfolios for an eventual recovery. When normalcy returns, consumer preferences will be largely unchanged, giving active managers a once in a decade opportunity to own best-in-class companies at fair valuations.

When uncertainty disrupts markets, investors look to previous sell-offs to form hypotheses about what the future might hold. However, today's markets are responding to something entirely different than ever before: The sudden stop to economic activity in an effort to "flatten the curve" is truly unprecedented. Social distancing and orders for shelter in place have halted business productivity, income, and spending across the globe. Other recent corrections have been different in nature and cause (housing and related derivative instruments during the Global Financial Crisis in `08 and valuations during the Dot-Com Bubble in `00), and thus investors can't confidently glean information from these events about how sharply and how far markets may fall.

Because of this, to have any conviction about when economic data and markets will turn a corner, one must rely on data about the virus itself, instead of the usual economic and financial indicators that have signaled a recovery in the past. Until new cases have stabilized or slowed and Covid-19 has been contained, quarantine and social distancing restrictions will persist indefinitely, causing disruptions that flow through to every segment of the economy.

Given so much uncertainty surrounding the extent and duration of the economic disruption, trying to pick a bottom in markets or predicting the shape of an eventual recovery is largely a fruitless activity: As of this writing, it's not possible to say that markets have bottomed or even to guess when they might. Without fully understanding infection rates through sufficient testing, having a more precise mortality rate, and having a timeline on when infections have peaked, the direction of markets is largely unknown. Despite lack of conviction on timing and direction in the short-run, actively managed portfolios have a rare opportunity to realign portfolios in advance of an eventual recovery.

Instead of attempting to time a market bottom, investors should use this once-in-a-decade opportunity to own best-in-class companies at modest valuations: Multiples have contracted (S&P 500 from 19x to 14x earnings) and after a historic bull run, long-term investors have a unique opportunity to buy into corporations characterized by quality brands and superior growth in both revenue and net income at a fair or discounted entry point. When fear strikes markets, investors indiscriminately sell the equity and debt of companies both good and bad. It is important to think about what has changed and what a company's prospects look like when things revert to normalcy. The likely answer, is not much has changed- consumer behavior and preferences won't change, innovative management teams will still innovate, and firm's with top-tier talent will continue to take market share. When the consumer is released from quarantine, she will still want to drink a coffee from Starbucks, while searching Google on her Apple laptop, wearing Nike sneakers. She will still bank at JP Morgan Chase and pay for lunch with a Visa debit card. These best-in-class companies have strong balance sheets, allowing them to bridge the gap during a pause in economic activity, however long that may be. Conversely, companies that are comparatively less able to adapt and less competitive, will likely remain that way coming out of this disruption, and will continue to underperform in the long-run.



Source: FactSet Research Systems

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